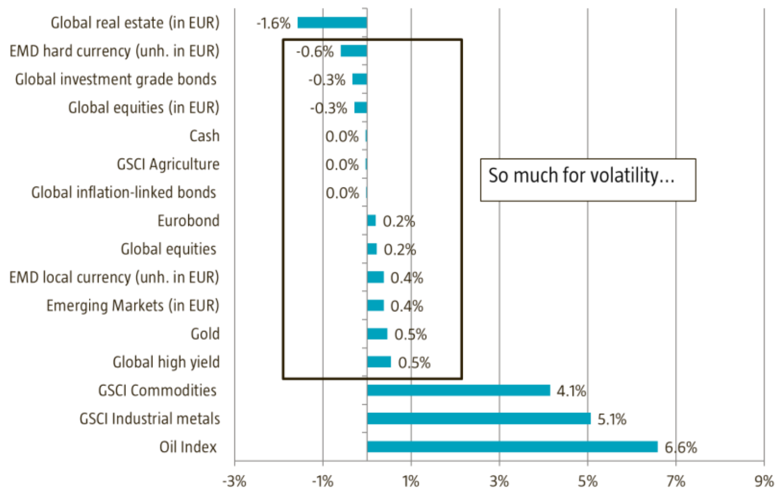
Multi-asset markets outlook

October 2016

General overview

Volatility returns, direction does not



We have cautious portfolio positioning

	Portfolio	BM	active
Equities Developed Markets	22.0%	25.0%	-3.0%
Equities Emerging Markets	5.0%	5.0%	
Real Estate Equities	5.0%	5.0%	
Commodities	5.0%	5.0%	
Core Gov Bonds 1-10	16.0%	20.0%	-4.0%
Core Gov Bonds 10+	7.5%	7.5%	
Investment Grade Corp Bonds	24.0%	20.0%	4.0%
High Yield Corp Bonds	6.0%	5.0%	1.0%
Emerging Market Bonds LC	5.0%	5.0%	
Cash	4.5%	2.5%	2.0%
EUR/USD	-3.0%	0.0%	-3.0%
EUR/JPY	0.0%	0.0%	
EUR/GBP	0.0%	0.0%	
EUR CASH	3.0%	0.0%	3.0%
Portfolio risk	5.54%	5.75%	

- Sticking to the script, with the start of September, volatility returned to the financial markets. After mostly ignoring economic and political news for over two months, all of a sudden stocks and bonds showed an increased sensitivity to news ranging from Deutsche Bank and Trump, to the Brexit and the Bank of Japan. Although all these developments are indeed important, the most striking one has been the Bank of Japan’s move to introduce yield curve targeting. Although there are some historical precedents (postwar US) for this, it is a relatively new measure, which means the central bank has neutralized the market pricing mechanism for the yield curve up to ten years. So much for free markets. The return of volatility has not meant that markets have taken a new direction though. Looking at the returns of the broader asset classes, most of them stayed within a remarkably tight range of +/- 0.6%. Commodities (partly thanks to the OPEC deal) and real estate were the exceptions to this.

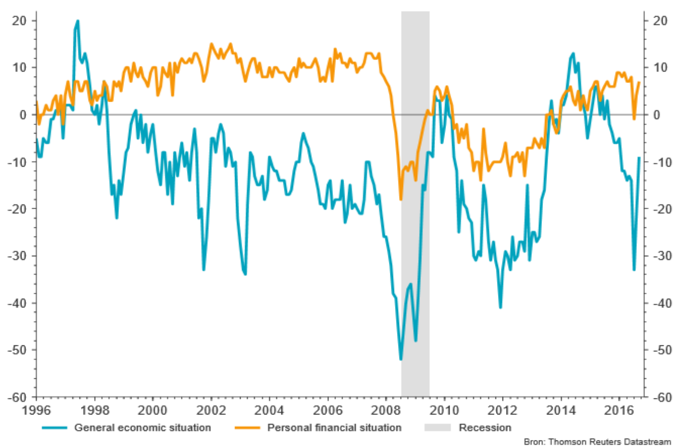
- We remain cautious with respect to the various asset classes. We do not like government bonds (the short-term risk may be limited, but so are returns); we are worried about equities (the US market is expensive and earnings keep disappointing); and are not completely convinced about emerging markets. We are taking a wait-and-see approach.

ROBECO

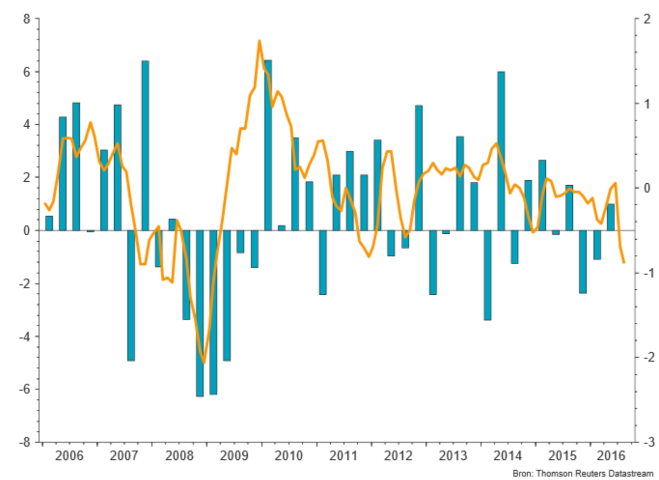
Economy

Our highlight this month: is the UK heading for a 'hard' Brexit?

UK consumers shrug off Brexit...for now



UK: business investments (bar for QoQ%) and intentions (line for RHS)

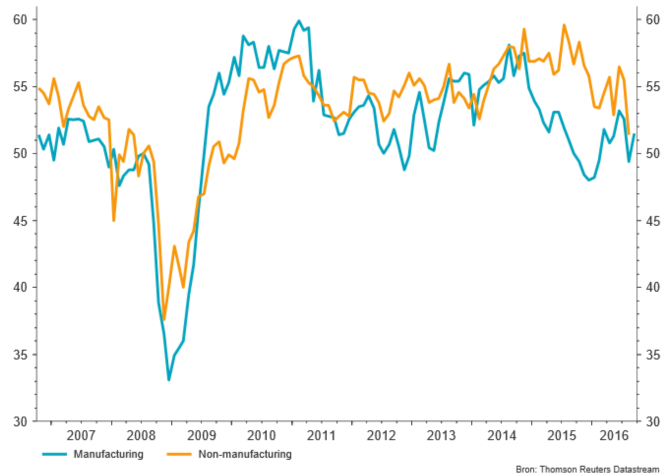


- The structural weakening of the pound after the Brexit vote has helped to mitigate its economic impact. In local terms the UK stock exchange is doing well. Consumer confidence shows resilience. But uncertainty over future relations with the EU, the UK's main trading partner, is dampening investment intentions.

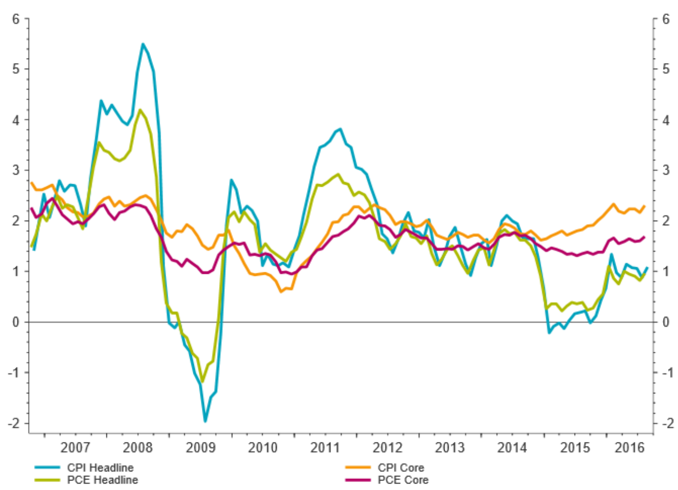
- To prevent a rebellion of Brexiteer Tories, UK PM Theresa May has declared her intention to trigger Article 50 of the Lisbon Treaty – which foresees a maximum of two year for divorce negotiations – by March 2017 and to give border control and sovereignty priority over access to the internal market. Essentially, she appears to be steering towards a so-called 'hard Brexit', which will cause the maximum economic damage in the long run. It remains to be seen if these two developments will actually materialize. In the first place, it is uncertain if the government has the sole prerogative to trigger Article 50, apart from the question of whether this would be politically wise. The viewpoint of the British government has already been legally challenged, possibly leading to the need to get parliamentary approval beforehand. Secondly, May is now facing a possible rebellion of the pro-internal market camp within the Conservative Party. With only a narrow Tory majority in parliament, the government could be forced to change its position. Even early elections can't be ruled out. The UK economy will face continued uncertainty, damaging investment and weakening growth.

United States

Rebound in ISM manufacturing data



US Inflation is upwardly mobile



- The ISM manufacturing index, which unexpectedly dropped back last month below 50, veered back over it, signaling expansion once again. Growth has been fairly tepid this year, though the third quarter is expected to be OK: the Atlanta Fed is currently predicting a 2.2% growth rate for the quarter, based on continuing consumer strength and a probably temporary upswing in exports.

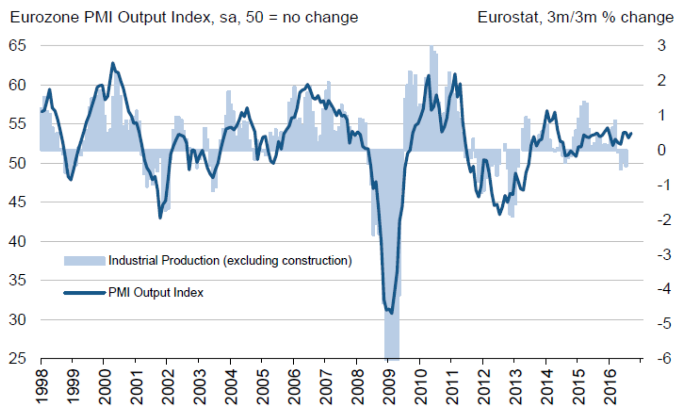
- With the preferred inflation indicator of the Fed – the core PCE – trending above 2.0%, it is not difficult to make a case for a modest rate hike. The regular November meeting of the FOMC, however, has to be ruled out as it takes place shortly before the US elections. On current economic trends, a December hike would be likely, except that the outcome of the elections is basically a toss-up at this stage, with 16% of the electorate undecided. A Trump win would make a December rate hike unlikely, as it is to be expected that markets will initially react nervously given his fierce anti free trade rhetoric, immediately threatening US-Chinese trade relations (and to a lesser extent, with Mexico). Nervous markets would push the FOMC to persist in its cautious wait-and-see attitude.

- The surprising agreement by OPEC to cut back oil production paves the way for a higher oil price, which will probably be capped at USD 60 due to the US shale revolution.

Economy

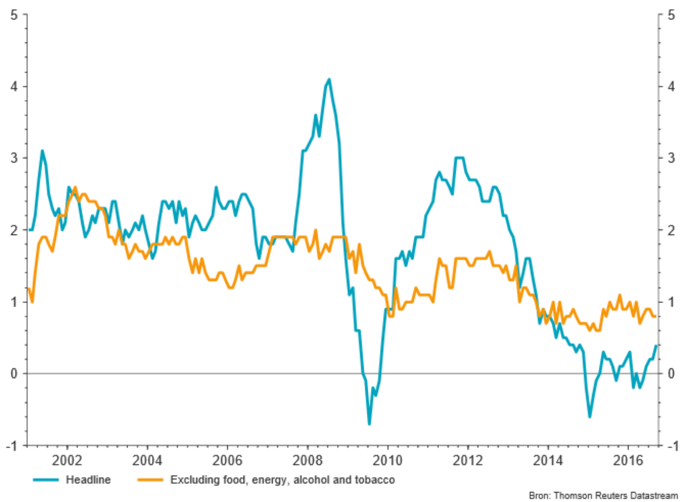
Europe

Mild acceleration of expansion in Eurozone manufacturing



Sources: IHS Markit, Eurostat

Euro area headline inflation is rising rapidly

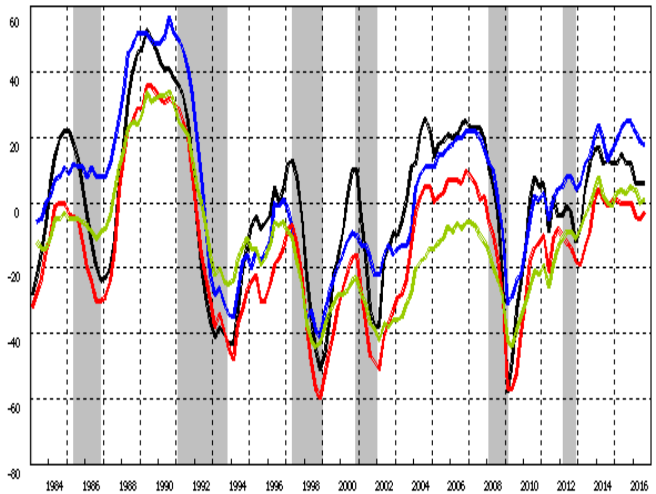


- The Markit PMI index for the Eurozone manufacturing sector suggested a mild acceleration, diminishing the pressure on the European Central Bank for additional action. This is quite convenient, as headline inflation due to baseline effects is also strengthening, though the core rate is still flattish. The ECB will take a wait-and-see attitude until December at least.

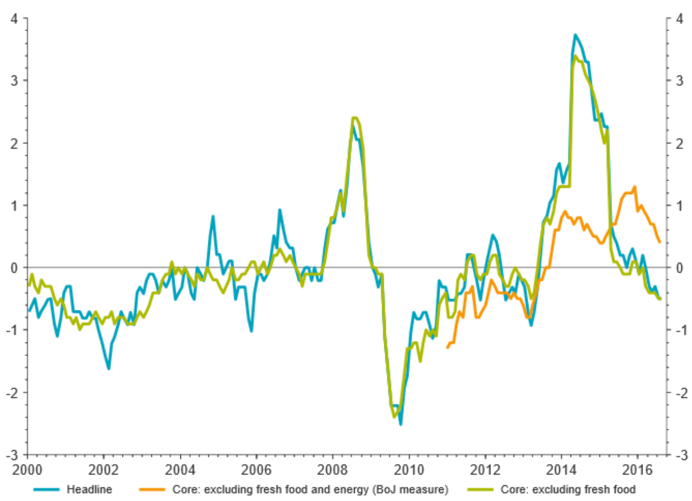
- The date for the Italian referendum, nominally on constitutional reform but effectively on PM Renzi's popularity, has finally been set for 4 December. This enables the Italian government to present an October budget, helping to win the divided electorate over to its intentions. Unfortunately, the government has been forced to downscale its GDP projections, limiting its room for maneuver. On the positive side the current banking woes in Germany gives it more leeway to find a solution for the recapitalization of Italian banks, as the ECB's expected soft stance towards German banks will generate a precedent for softness towards Italian banks. It is unlikely that the new strict EU bail-in rules will be followed to the letter. Should Renzi lose, this risks a flaring up of the European debt crisis, as investors would be inclined to conclude that Italy is a hopeless case, threatening the integrity of the Eurozone. A Renzi win would strengthen the euro, with the next political event risk the French presidential elections in 2017.

Japan

Japan's Tankan: large manufacturers (black line) have a flattish reading



Heading towards deflation



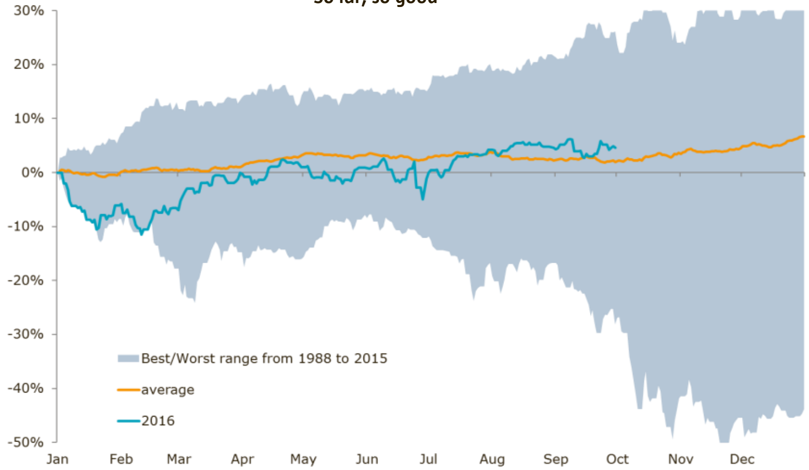
- The fact that isn't easy to keep track of the 'true' development of the Japanese economy was illustrated by an indicator published by the Bank of Japan which suggested that GDP growth in 2014 had amounted to 2.4% instead of the official minus 0.9%! This increases doubts over the accuracy of Japanese GDP figures.

- A closely watched indicator of the heath of the Japanese economy is the producer confidence of large manufactures. Its latest reading was flat, suggesting that large manufacturers succeed in coping with the strength of the yen.

- The Bank of Japan has made a dramatic switch towards price control instead of raising the quantity of QE after reaching the limits of its current QE program. This is due to the increasing scarcity of JGBs, and already possessing one-third of the outstanding stock, while being confronted with steadily declining CPI figures. The central bank is now explicitly targeting the yield curve (Yield Curve Control) by expressing its wish to fix the 10-year JGB yield at 0%. Although there are precedents for this new policy, such as in the US between 1942 and 1951, this basically fixes the yield curve and protects banks from the consequences of negative short-term interest rates by making sure that the yield curve is positively sloped. The new policy also facilitates an aggressive fiscal policy by the Japanese government, as it will limit any fallout from reflationary fiscal expansion by preventing rising long-term yields.

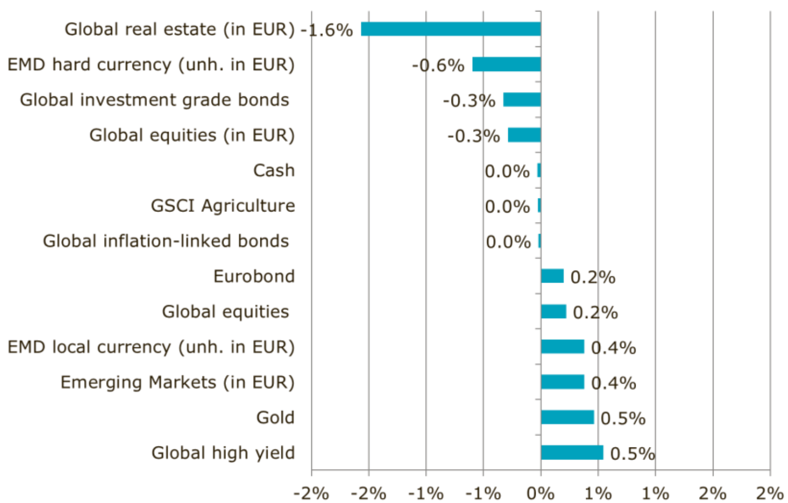
Equities (I)

So far, so good



source: Bloomberg, MSCI world

No direction

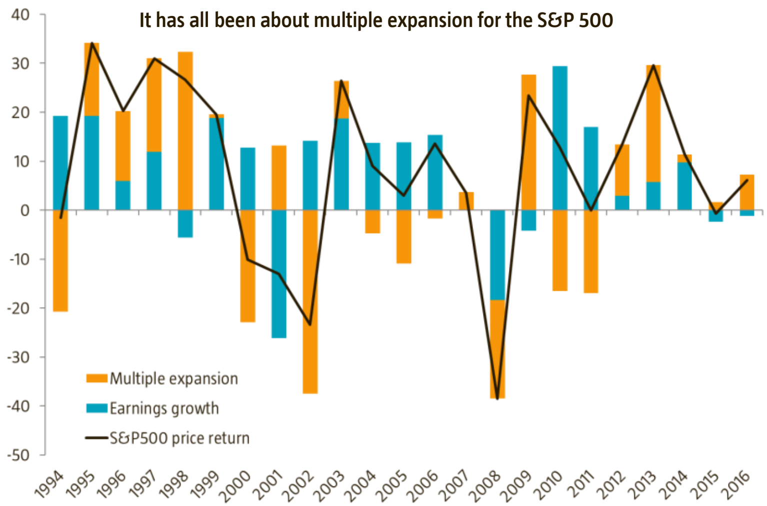


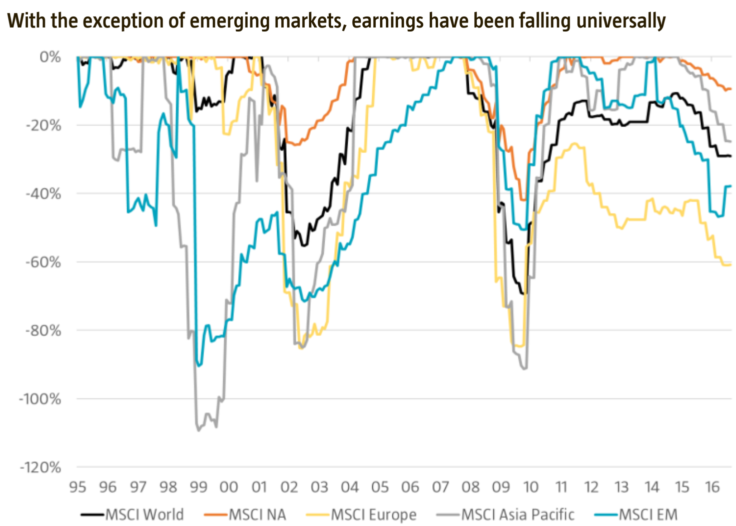
- Volatility picked up in September, with stocks breaking away from the near-zero daily changes that were seen for most of the summer. After carefully ignoring most news for over two months, uncertainty seems to have returned, with stocks all of a sudden giving jittery reactions to news ranging from Deutsche Bank and Trump, to ECB tapering rumors and economic data.

- Jittery, yes, but if you think this means that financial markets are taking a clear direction, you are mistaken. Looking at the September returns for the various asset classes we initially thought our Excel spreadsheet was broken, as almost all of the broader asset classes ended within a 0.6% range compared to the start of the month. In other words, even though there was plenty of movement during the month, on a net basis financial markets ended almost exactly on the same point that they started. Real estate was the only asset class to break beyond the 0.6% range, recording a 1.6% loss. September therefore brought increased daily volatility and limited returns: it goes without saying that we would have preferred to see this the other way around.

- So what do we expect the next move to be? Over the past couple of months we have become more cautious on the near-term prospects for stocks, with the apparent lack of earnings growth our biggest concern right now.

Equities (II)



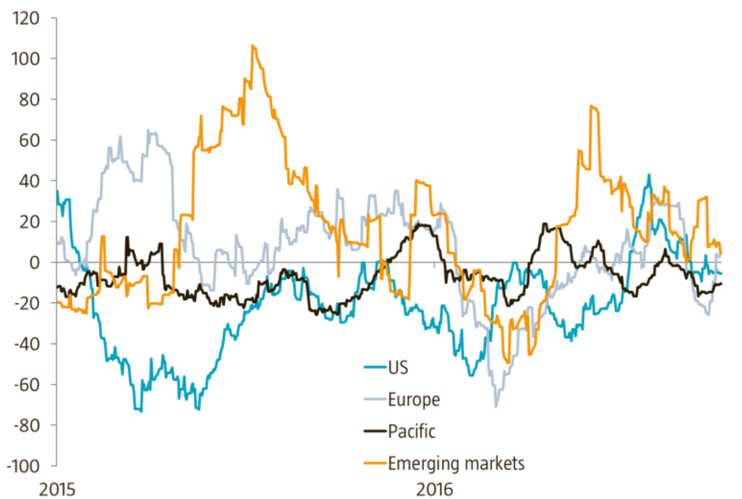


- Looking at the leading US market, 2016 is on track to become the fifth consecutive year in which share prices have risen faster than underlying earnings, which means that they have continually become more expensive over that timeframe. To put this into numbers: whereas the S&P 500 was trading at a PE multiple of around 13 back in 2012, we are now paying more than 18 times trailing earnings. Although this is uncomfortable, we know from past experience that valuation alone is never a good reason on which to base your tactical call. The more worrying part is the steady deterioration of the underlying earnings which has taken place at the same time. Assuming that US earnings remain stable for the remainder of the year, it means that average EPS growth has been only 3% over the past five years. This trend of low earnings growth is not just a US phenomenon, but rather a worldwide event, closely linked to the low-growth environment we have become caught up in.

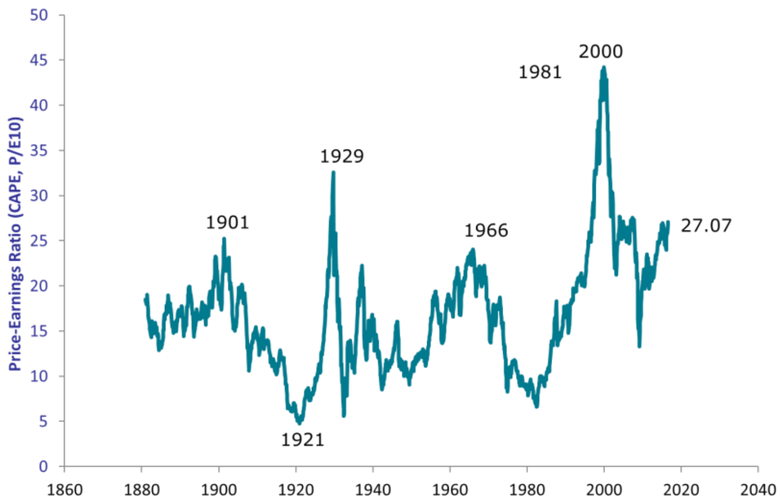
- Low (or negative) earnings growth combined with higher stock prices: how long can this continue? So far, stock markets have been propped up by the ultra-loose monetary policy pursued by central banks, but there is a limit to how much further this can carry the markets. Indeed, the Bank of Japan already appears to have reached that limit, with the latest two monetary ‘innovations’ (negative real rates (February) and yield curve targeting (September) failing to impress **>>**

Equities (III)

No surprises from economic data



The Shiller PE is at its highest level since 2007



- markets longer than one day. For Japanese stocks, the yen continues to be the main variable to watch. So far, the trend of strengthening has not been broken. At the other end of the spectrum, the Fed still has the ability to push the market higher, but the preferred way forward by far would be to see earnings actually rebound. Although we continue to believe that there is room for upward surprises in the broader US economy, growth will not be without risks either: the accompanying higher wages and increased interest rates pose a threat to high US margins. The mantra has been 'bad-news-is-good-for-stocks', as this would keep the Fed from raising rates, which raises the question over what would happen if the news turned out to be good for a change.

- As stated, we remain cautious. Valuation may not be a good market timing mechanism, but expensive stocks are more susceptible to unexpected news. With the increased levels of corporate debt, the growing rise of populism, as well as the uncertain growth outlook of the Chinese economy, we can see a number of potential market-moving events on the horizon. The main risk to our underweight in equities appears to be the return of the low volatility trading environment, with stocks resuming their natural drift higher. Such an outcome cannot be excluded, but does not seem very likely right now. As such, we continue to stay underweight equities for now.

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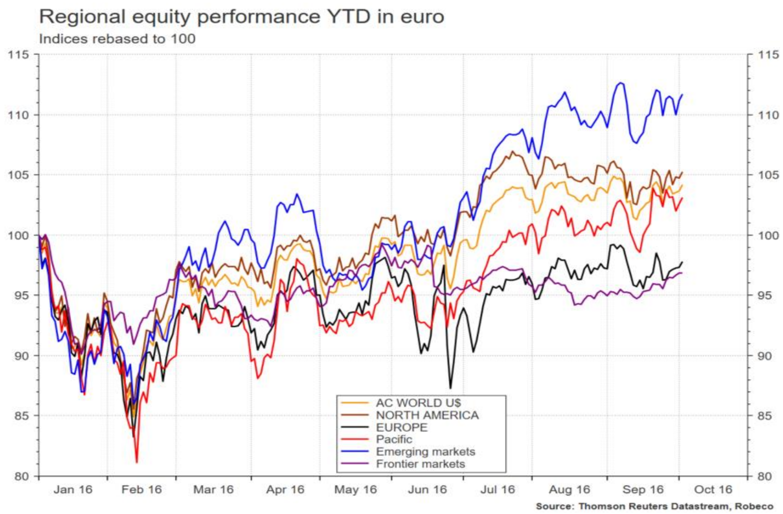
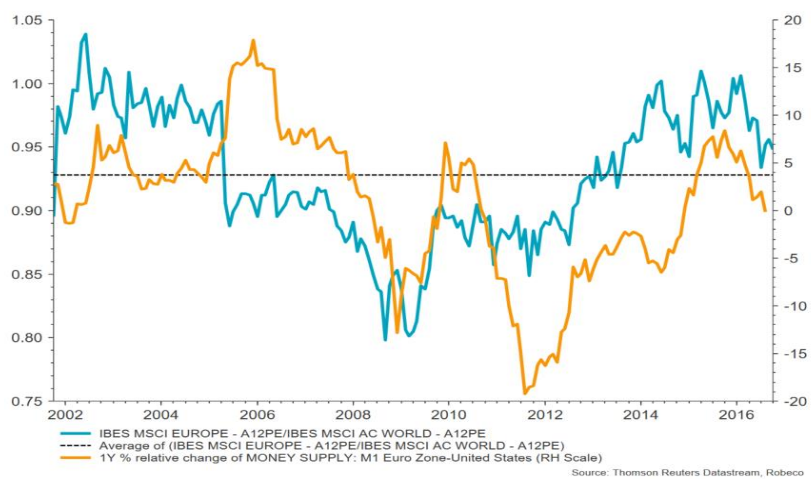
Developed Market Equities

Equities

Some ground has been lost



Europe is not attractive enough on forward PEs

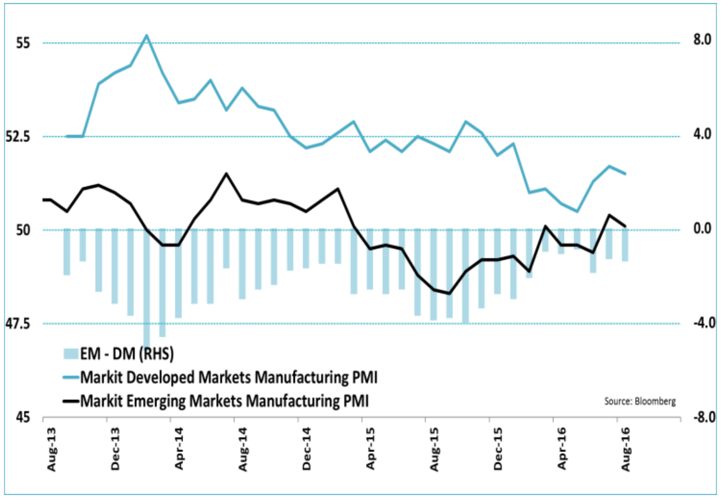


- Global stock market momentum on a one-month basis in euros has become negative, especially for European stocks, closely followed by the US. Although Japan showed negative returns in local currency over September, measured in euros, Asia Pacific equities maintained a positive momentum. Despite low implied volatility, investor uncertainty has tilted rather higher, not lower, on politics. The threat of a hard Brexit; some European banks put under scrutiny; the upcoming Italian referendum; the possibility of a Fed rate hike this year, while Trump is down but not out, are all keeping developed market equity momentum suppressed. The UK is an exception as its companies profit from the cheapening British pound. Longer-term momentum (12m-1m) still favors US equities within developed markets, with Europe clearly lagging on this metric.

- Developed equity valuations based on CAPE increased last month, reflecting the low volatility environment. On a CAPE metric, Europe shows a discount to the US, as it has done for some years now, which is partly a function of elevated political risk. However, looking at forward PEs, European equities are not outrightly cheap compared to US equities, even as the relative pace of broad money creation in Europe has slowed versus the US. Earnings growth is improving, but with lingering political risk in Europe, US and Pacific equities remain on par with European equities in our near-term view.

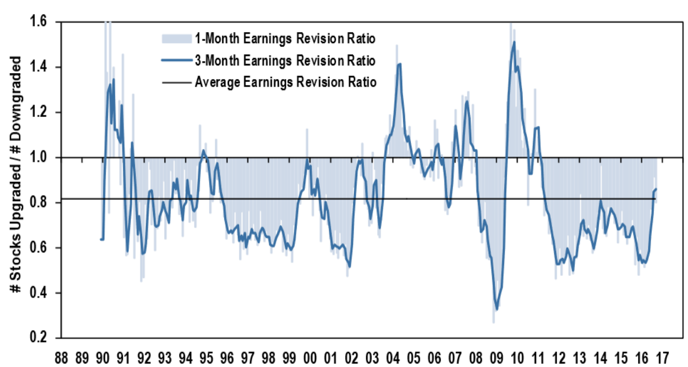
Equities: Emerging vs. Developed (I)

Emerging v developed market manufacturing PMI



Emerging market earnings

Chart 13: Trends in Earnings Expectations - Global Emerging Markets



Source: BofA Merrill Lynch Global Quantitative Strategy, MSCI, IBES

- Emerging market equities beat developed markets equities again in September (albeit with a small margin) as the Fed refrained once more from raising rates.

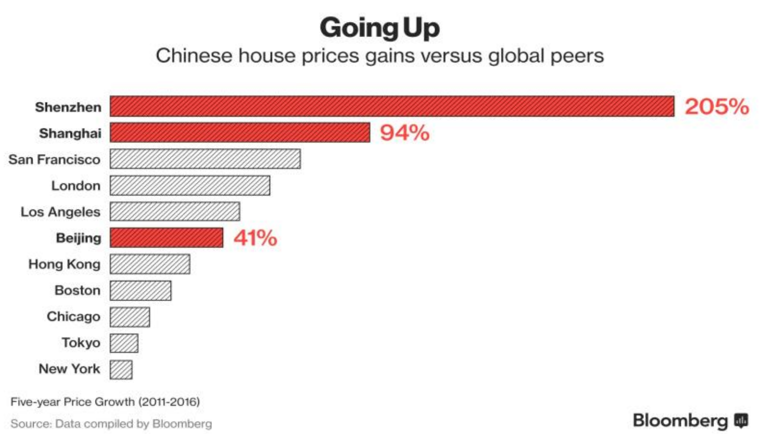
- Growth remains sluggish in emerging markets, although some signs of stabilization are visible. The emerging market manufacturing PMI in August topped 50, but continues to lag the developed market manufacturing PMI. Weak spots are found in Brazil, South Africa and South Korea, with Russia recovering.

- While relative growth remains challenging, other factors are looking more positive for emerging market equities. As we mentioned last time, one important factor that has made us more positive is earnings. After years of decline, emerging market earnings are now growing again, and earnings revisions have moved up to above the long-term average.

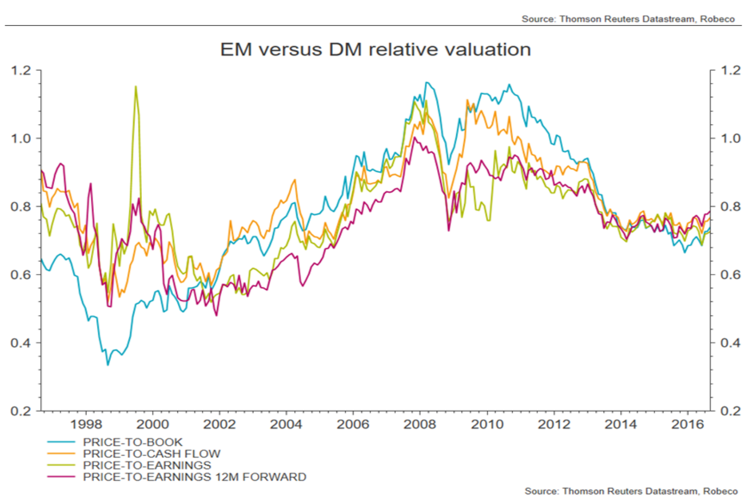
- Next to earnings, global liquidity remains abundant. The Fed refrained once more from raising rates. Also the Fed 'dot plot' suggests that rates are likely to stay lower for even longer. With the ECB and Bank of Japan continuing their massive QE programs, liquidity seems to be warranted, at least for now.

Equities: Emerging vs Developed (II)

Earning estimates are moving up



Valuation discount



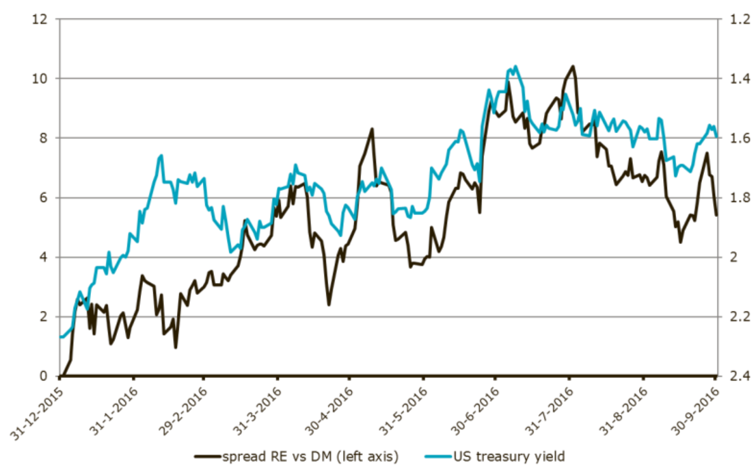
- Also benefitting the outlook for emerging markets is the OPEC 'deal' to limit oil production. Details have yet to follow, but the surprise move is surely positive for oil prices, and therefore for emerging market equities. As a group their performance is closely correlated with the trend in commodity prices.

- On the downside, China remains a significant risk. Its manufacturing PMI is still at subdued levels, although industrial production has picked up a little. The housing market, however, is overheating again. An increasing number of cities have implemented measures aimed at reducing property transactions, but so far with little effect. The chances of a hard breakdown of the real estate market, as we saw only a couple of years ago, have increased.

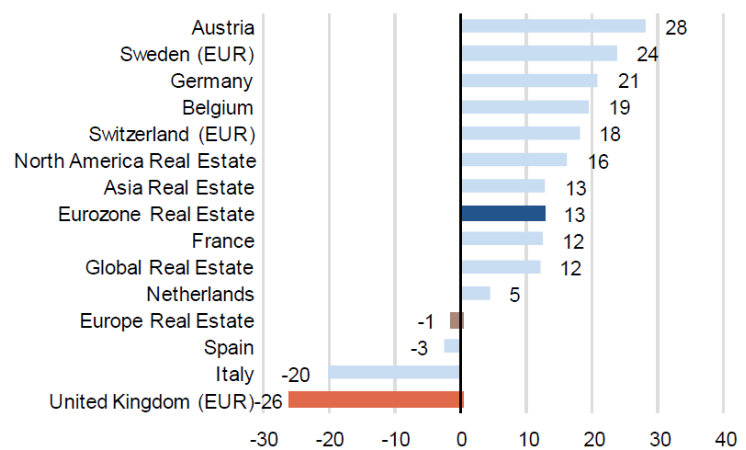
- We remain overweight in emerging market equities. On balance the outlook has improved somewhat as central bank policy is set to be very accommodating in the near future. The OPEC deal is also an unexpected positive. The recovery in the relative performance of emerging equities over those of developed markets is still fragile, however. Growth is improving, but only very modestly. We expect the Fed to raise rates in December, which is not fully priced in at this moment, while in Europe banking and Brexit risks are growing.

Real estate

Relative performance of real estate



European real estate compared to other markets



Source: SG Cross Asset Research/Equity, Datastream as of 20 September 2016

- The Fed meeting was clearly the main event for real estate movements in September. Speculation about a possible rate hike pushed bond yields higher, resulting in real estate underperforming. As yields continued to rise until the end of the month, the S&P developed real estate index (USD) declined by 0.7%.

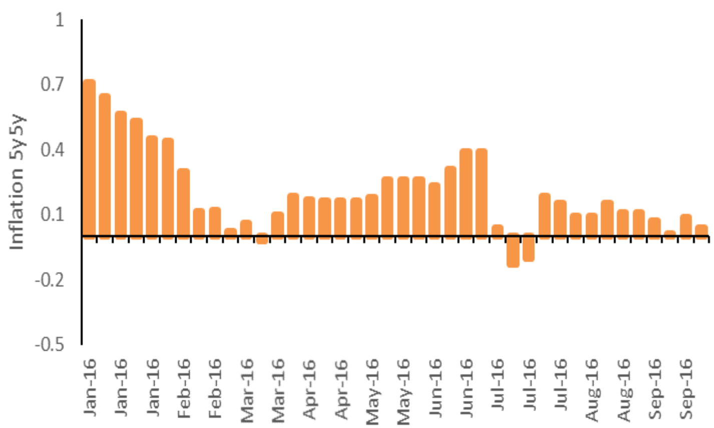
- European real estate shows a strong divergence between countries. The UK sector suffers from renewed Brexit concerns, while German real estate is growing very fast, thanks to the continuing low Bund yield and the CSPP program. European real estate is, as a consequence, very expensive. The Bank of Japan also presented its next round of stimulus. As the focus is now more on the yield curve instead of buying assets, the amount of J-REIT buying was left unchanged. The BoJ is now keeping an eye on the amount it wants to buy in relation to the total market value of the specific J-REIT to reduce market disturbance. J-REITs are expensive, while other segments such as developers look more attractive.

- The stimulus programs of central banks still counterweights the heavy valuation in many areas in the real estate sector. We remain neutral.

AAA Bonds (I)

Pipeline inflationary pressures are rising

Inflation expectations in Japan have not moved at all



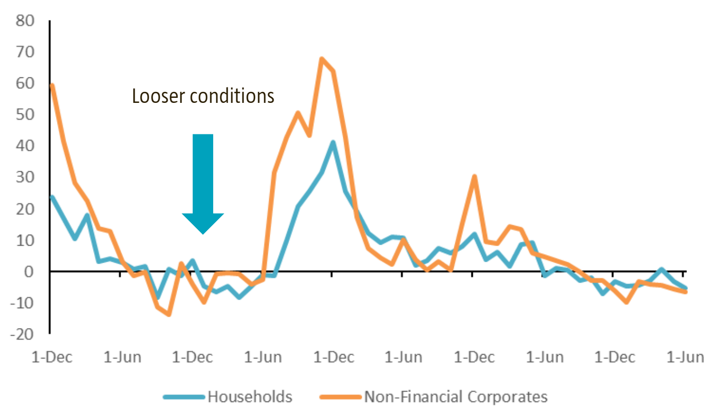
- In September only the Bank of Japan changed its monetary policy. Both the Fed and the ECB refrained form making any changes. It looks, however, that some tension is building within the Fed, as the decision to stay put was not unanimous, with three members dissenting. The Fed did signal that a rate hike in December remains on the table. While this would be in line with our expectations, we caution over thinking that this is done deal. If one thing has become very clear about the current Fed, it is that they talk a lot but are committing to nothing. If this Fed is indeed as data dependent as it claims, then the case for not raising rates is getting weaker. Positive data is picking up, and pipeline inflationary pressures seem to be building in the economy. Just like us, the market isn't completely convinced, and is putting the probability of a hike in December at 60%.

- As for the Bank of Japan, from now on it will not only set the short-term policy rate, but also the 10-year yield. This new 'Yield Curve Control' framework is currently targeting a 10-year rate of around 0%. The BoJ also announced that it wants inflation to overshoot its 2% target. The combination of keeping the long-term nominal rate flat while allowing an inflation overshoot should be just what the doctor ordered, as it means **>>**

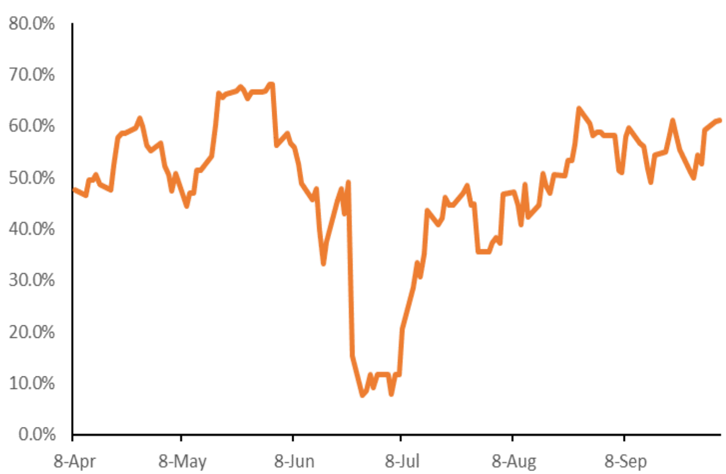
Fixed Income

AAA Bonds(II)

ECB Lending Survey: lending conditions are improving



The probability of a Fed hike in December is around 50%



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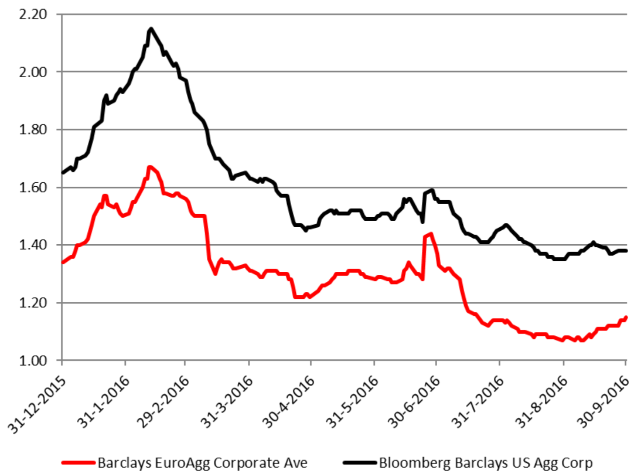
- the real yield would be pushed into negative territory. The only problem with this is that the BoJ has failed to hits its inflation target time and time again, and therefore lacks the credibility to revive inflation expectations.

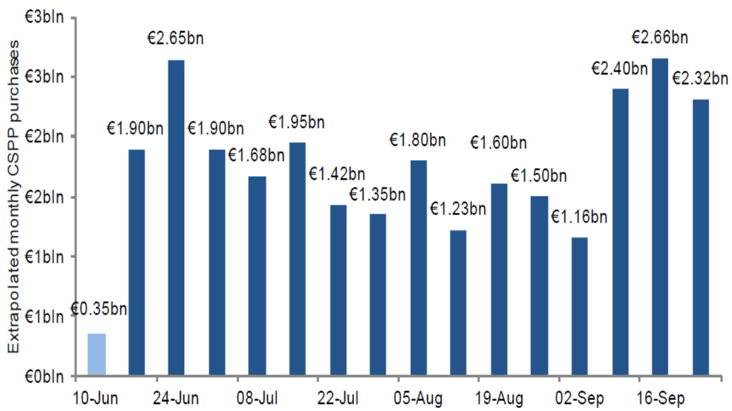
- The ECB didn't provide any clarity on the future of its asset purchase program, but just stuck to the narrative that non-standard monetary policy will run at the same clip of EUR 80 billion until the end of March 2017 or beyond, if a sustained adjustment in the path of inflation is not visible. The focus will therefore be on upcoming inflation numbers and any ECB rhetoric for clues on the future of the program. In line with consensus, we expect inflation to pick up towards the end of the year, due to base effects. It will be interesting to see if the market and the ECB are willing to ignore this. We think the improvement of growth relative to its potential (around 1%) and the loosening of financial conditions will make it more difficult for the ECB to just extend the purchase program. Also, the scarcity problem of German bonds will need to be addressed at some point. All in all we think it will be difficult for the ECB just to prolong the current program, and we expect it to be adjusted one way or another. As long as uncertainty about the future of the program lasts, we think there is a window for rates in the euro area to rise. So we maintain a small underweight position in bonds.

Investment Grade Credits (I)

'All quiet on the Western front': hardly any spread movements in Europe and the US



CSPP since the start



Source: SG Cross Asset Research/Credit

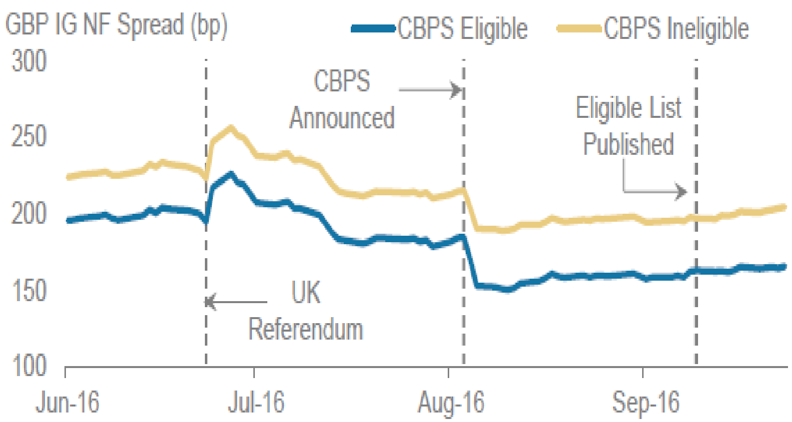
- Credit didn't change much in September. In Europe, spreads widened by the amount they had tightened in the month before (6 bps) and closed at 1.14%. At a global level, spread movements were even smaller. US spreads tightened by exactly 1 bp, after some movement during the month in the sovereign markets.

- At the moment, yields in the credit market are vulnerable to what happens in the government bond market, which in turn is highly sensitive to what the central banks have to say. That varied last month from 'nothing special' (ECB) to 'yes, we're going to do something but not now' (Fed), to 'change of course' (BoJ). Perfectly following the movements in sovereign rates, US (and global) credit yields rose about 10 bps during the month, and declined after the Fed statements on interest rates.

- In Europe, the ECB is more aggressively buying bonds in its CSPP program than expected, buying a record level in the first weeks of the month. The ECB seems to prefer 3-year to 10-year bonds, with a 1% to 2% coupon, according to the data the ECB releases afterwards. The program lasts at least until March 2017 and is very dominant on the European market. Financial issues around Deutsche Bank or the Italian banks don't seem to have significant effect on the risk premia.

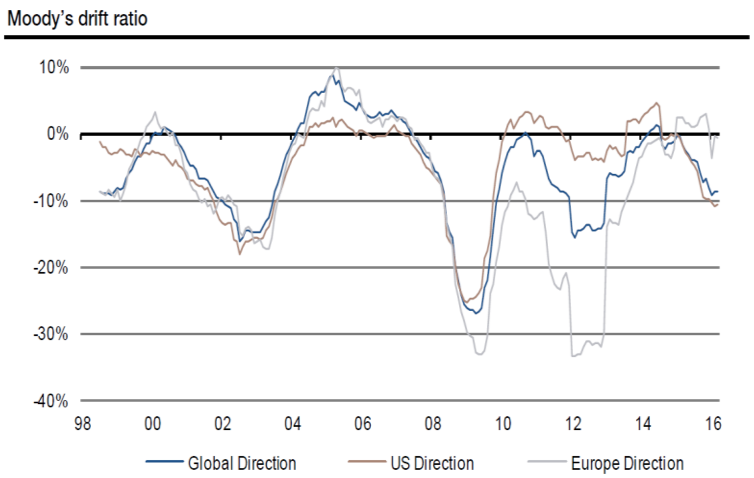
Investment Grade Credits (II)

The spread impact for (non-) eligible bonds in the CBPS program in the UK



Source: BoE, Markit, Morgan Stanley Research

Credit quality is heading down, especially in the US



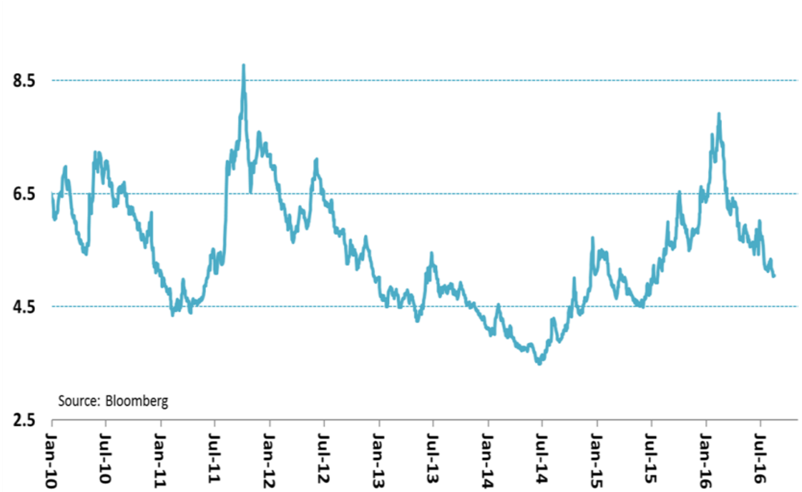
- The Bank of England kicked off its CBPS program in the last week of September. The market impact of the GBP 10 bln bond-buying program is modest, also because the list of around 260 eligible bonds was disclosed upfront. It was no surprise that spreads of non-eligible bonds widened (fractionally) more than those of eligible bonds.

- In the US, the Fed meeting turned out to be a non-event, with no action expected until the next president has been chosen. A thing to worry about is credit quality. As can be seen in the bottom chart, which shows the number of issuer upgrades minus downgrades per region, the trend is clearly deteriorating. Leverage is still rising, which makes US credits vulnerable to a possible economic slowdown.

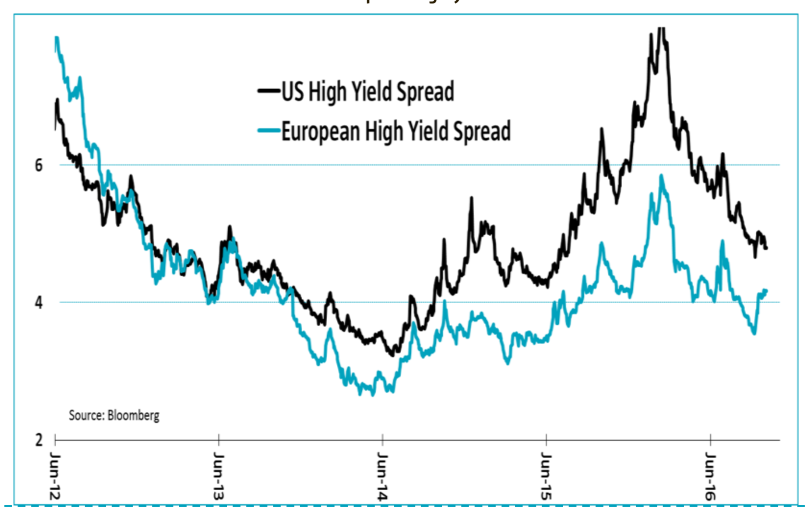
- We still have an overweight position in European credits as the ECB will be in the market as the 'ultimate buyer' for the coming period. Possible political turmoil in Italy, or high penalties to be paid by German banks, doesn't seem to be having any effect. We expect spreads to stay at low levels, with investors looking at alternatives with slightly more yield, like financial credits. These credits are not in the CSPP universe, but have an extra risk premium to offer. That said, overall risks are rising, so we look at the credit market with increasing caution.

High Yield (I)

Global high yield spreads



US vs. European high yield



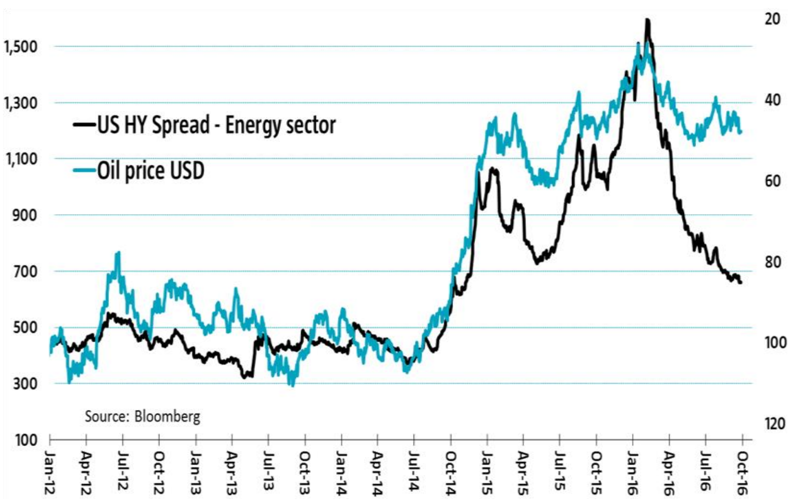
- September proved to be a tale of two high yield markets. In the US, high yield spreads tightened, partly due to an unexpected OPEC oil production 'deal', while spreads widened in Europe as banking issues dented sentiment. Overall, spreads tightened by an average of 6 bps globally, and high yield gained 0.5%.

- At the end of September, OPEC surprised markets by agreeing on the framework for a deal to limit crude output. Just a few weeks earlier, Saudi Arabia had signaled that any decision was unlikely. So even though specific targets for each member have not been agreed upon, the surprise decision was enough to push commodity prices higher. This translated into tighter spreads for high yield energy and commodity companies. Since these companies have a relative large weight within the US high yield universe, this was more than enough to compensate for weaker investor sentiment.

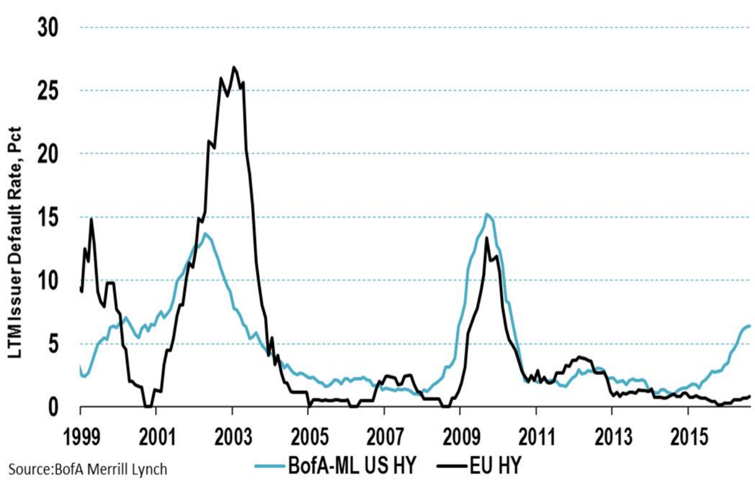
- The drop in investor sentiment had a lot to do with the European banking sector. Deutsche Bank is looking to settle multiple lawsuits that will cost the company billions of dollars. But other banks are under pressure as well. Commerzbank is doing poorly, as are the debt-loaded Italian banks. Hence, European spreads, both credits and high yield, widened.

High Yield (II)

US high yield energy spreads



Number of defaults globally



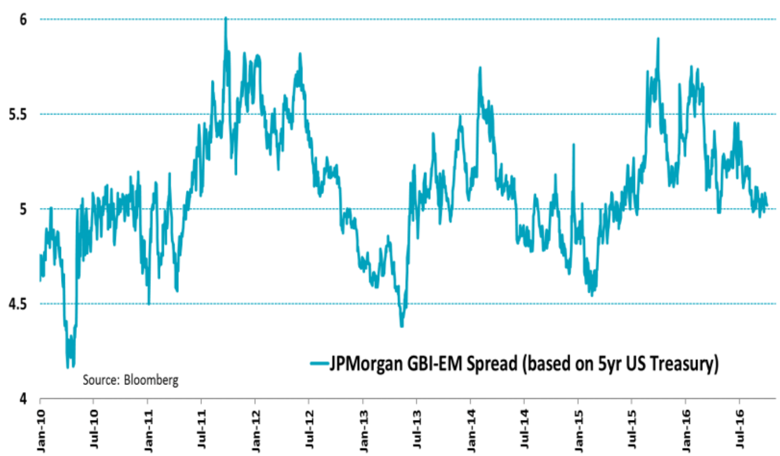
- Low to moderate GDP growth in combination with very loose policy by central banks are circumstances that suit high yield bonds perfectly. Defaults remain low, and are concentrated in the US energy sector. But with OPEC taking action, things look more upbeat. And with the Fed postponing a rate hike yet again, this scenario is likely to continue for the time being.

- However, as mentioned earlier, European bank issues could increase risk aversion among investors. In addition, valuations have become less compelling. In the energy sector, valuations look somewhat elevated, as the chart on the top left reveals.

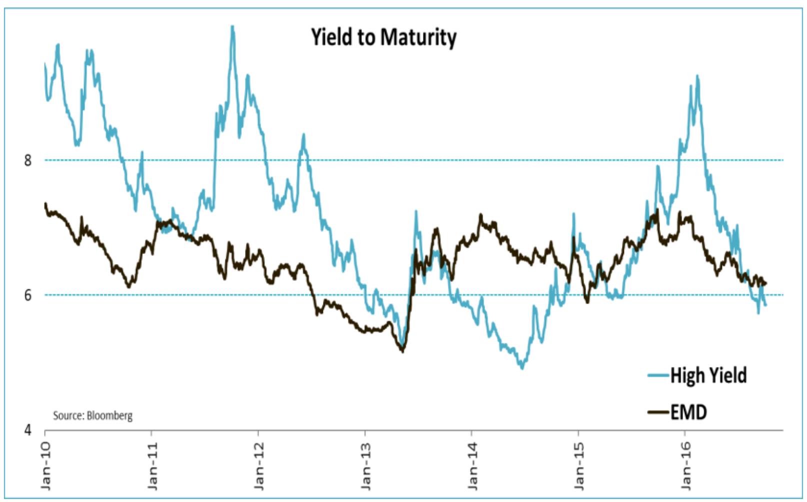
- High yield defaults remain concentrated in the US, and primarily in the commodity-related sectors. Without any negative shocks , we see little risk of the start of a broader default cycle. Valuations compared to (European) government bonds remain attractive. However, as some of the attractiveness has vanished, and the asset class remains vulnerable to a change in risk attitude, we are sticking with the smallest possible overweight for now.

Emerging Market Debt (I)

Emerging market debt spreads based on the 5-year US Treasury yield



Yield to maturity: emerging market debt vs. high yield



– With spreads, yields and currencies basically flat, emerging market debt in local currency realized a return of 0.4%, close to the monthly running yield. The average spread over 5-year US Treasuries tightened by just 3 basis points.

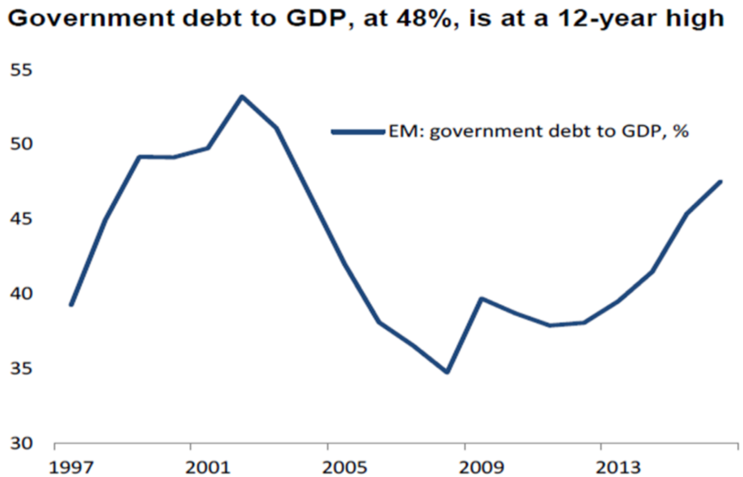
– The fact that yields didn't change much doesn't mean the relative value didn't change as well. As the graph on the bottom left shows, the yield to maturity of emerging market debt now tops the yield to maturity of high yield. Since financial markets have been characterized by a strong search for yield, emerging market debt has become more attractive from this angle.

– From a fundamental perspective, things look reasonable. Growth is stabilizing, although in some countries the situation remains extremely fragile. South Africa and Turkey, where the government has cut expected GDP growth from 4.5% to 3.2%, are two important examples. But the outlook for Brazil also remains muted. It's exactly in these countries that political tensions have risen greatly in recent months, making them vulnerable to a turnaround in investor sentiment. Together, Brazil, South Africa and Turkey make up roughly 30% of the JPM GBI-EM Global Diversified Composite Index.

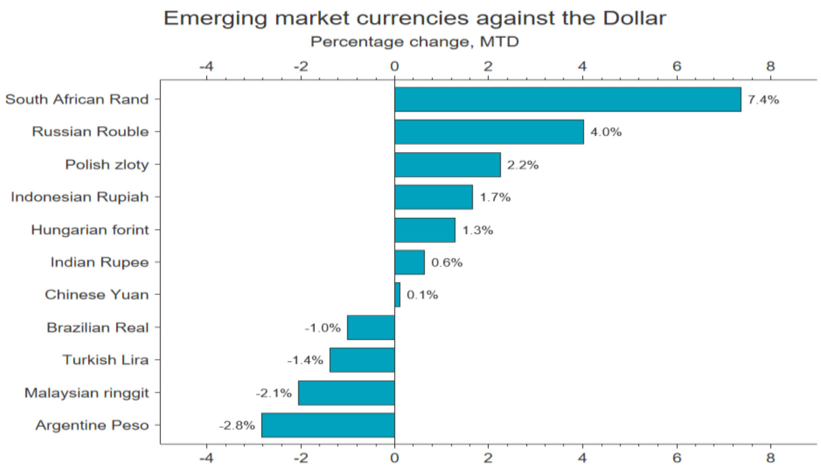
Fixed Income

Emerging Market Debt (II)

Government debt to GDP



Currency performance



Source: Thomson Reuters Datastream, Robeco

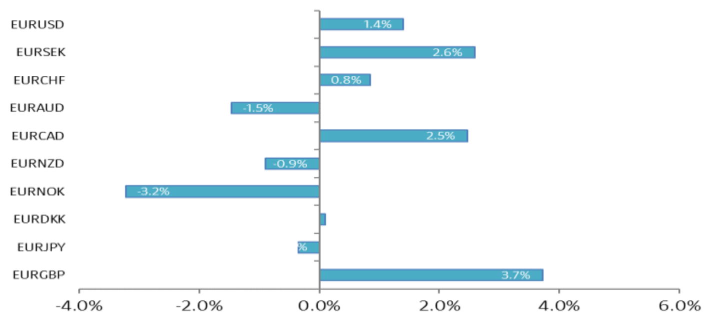
- As we mentioned last month, an interesting development to keep an eye on is the gradual increase in debt-to-GDP ratios, which have climbed to their highest levels in 12 years. However, as the absolute level of debt-to-GDP is 'only' at 48%, this does not pose an imminent risk. That said, any slowing of economic growth will force a number of emerging countries to increase government spending. This could push up debt-to-GDP ratios further.

- On average, emerging market currencies drifted marginally higher in September. After a big loss in August, the South African rand gained last month. The chart on the bottom left also shows that monthly changes in currencies remain volatile. In our view, emerging currencies remain prone to sell-offs, as they offer an instrument to solve imbalances and/or a reversal in risk appetite. That is the case even though some of these currencies are attractively valued from a longer-term perspective.

- From a yield perspective, emerging market debt is now the most attractive asset class. However, political risks have increased, and we think a turn in investor sentiment is likely reflected in emerging currencies. Since we have a cautious stance towards financial markets, we remain neutral on emerging market debt.

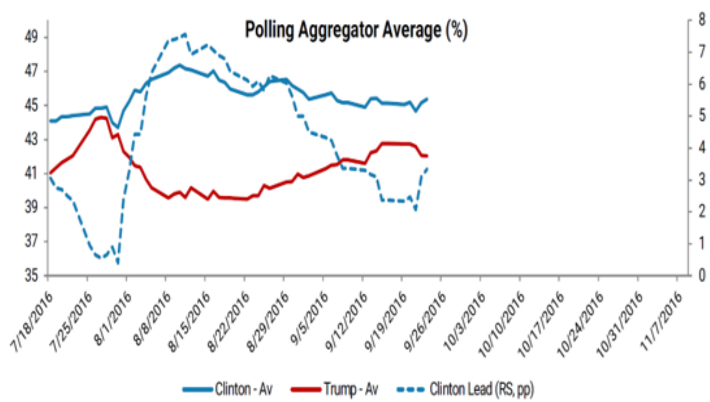
FX (I)

Monthly returns for the G10



Source: Bloomberg

In August, Clinton lost her comfortable lead



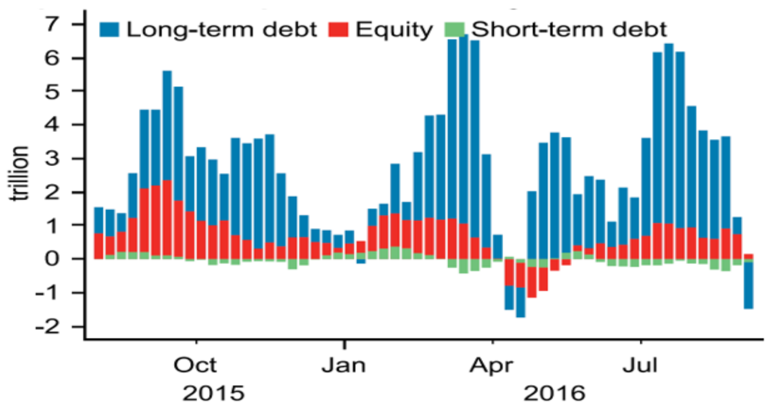
Source: Morgan Stanley, New York times, Huffpost Pollster, RealClear Politics

- The euro was one of the stronger currencies within the G10 in September. It only lost ground against the so-called commodity currencies and the yen. This is the second consecutive month in which commodity currencies have strengthened. Their better performance is tightly linked to the performance of emerging market assets, which has been quite good due to the positive shift in sentiment. The euro gained the most against sterling. While we expected that the pound had not fully discounted the impact of the Brexit yet, we were caught of guard by the sudden shift in sentiment, after it firmed in August.

- We have been bullish on the US dollar for some time now, but must admit that we are quite disappointed with its performance. Once again the Fed choose not to raise rates, and while it looked like they signaled that this will happen in December, we are not completely certain that it will. For now we will give the Fed the benefit of the doubt and maintain our long US dollar position against the euro, but will monitor developments carefully. What also weighed on the US dollar is the race for the presidency. What Brexit taught us is that one shouldn't underestimate the impact of elections on currencies. In August, the comfortable lead that Hillary Clinton had on Donald Trump shrank substantially. The more uncertain outlook most probably was a drag on the US dollar.

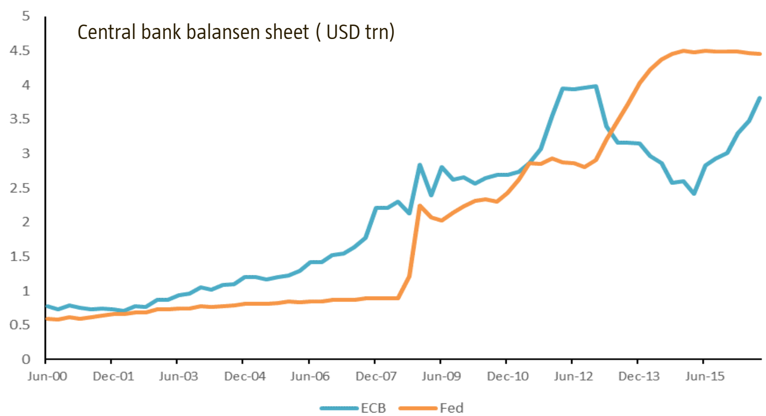
FX (II)

Japanese investor purchases of foreign securities (4-week average)



Source: BNP Paribas

The ECB balance sheet still powering ahead



Source: Bloomberg

- The foreign exchange markets still seem to be pondering whether the latest adjustment to monetary policy by the BoJ is positive or negative for the currency. We think that the BoJ did manage to sow seeds to weaken the yen in the longer term. Firstly, it addressed the issue that cutting rates further into negative territory will not automatically be seen as bad for the financial sector. Secondly, it firmly opened the door for monetary financing of the deficit, as the longer-term rate is no longer set by the market, but by the BoJ. In the short term, however, we noticed that Japanese investors lowered their purchases of foreign securities, indicating that capital flight has currently stopped. Whether this is just a blip or a trend is still uncertain, and will be monitored closely.

- We maintained our overweight US dollar position against the euro. Unfortunately, the EUR/USD remained in a tight range. Besides a hesitant Fed, we see some developments emanating from the Eurozone that pose a risk for this position. It still has a positive current account and the ECB is dragging its feet to give clarity on the future of its purchasing program. It risks losing the initiative. If the ECB fails to deal with this properly, we fear that we will be looking at stronger euro, with all the negative consequences (tighter financial conditions, etc.) that this brings to the euro area.

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